

Message Text

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FM SECSTATE WASHDC

TO USDEL SECRETARY PRIORITY

C O N F I D E N T I A L STATE 292926 TOSEC 310395

LIMDIS FOR UNDER SECRETARY ROGERS FROM SORENSON

FOLLOWING REPEAT LONDON 19355 ACTION SECSTATE DTD 01 DEC

QTE

C O N F I D E N T I A L LONDON 19355

LIMDIS WITH DISTRIBUTION FOR S, D, E, C. P, EB, EUR,
S/P, TREASURY, NSC, FRB ONLY

E.O. 11652: GDS

TAGS: EFIN, UK

SUBJECT: SITUATION REPORT, DECEMBER 1

REF: (A) STATE 267168; (B) LONDON 19262

1. CHANCELLOR HEALEY IN PARLIAMENTARY DEBATE LAST NIGHT
HINTED AT CUTS IN DIRECT TAXATION LINKED TO THE NEXT
STAGE OF INCOMES POLICY, SUCH CUTS POSSIBLY COMING IN
THE SPRING BUDGET ONCE SHAPE OF THE THIRD PAY ROUND IS
KNOWN. COMMENTING ON DISCUSSIONS WITH THE IMF, HE SAID
"THE IMF IS AS ANXIOUS AS WE ARE TO ENSURE THAT ANY
WE SHOULD NOT HAVE TO TAKE ANOTHER BITE AT THE CHERRY".
BRITAIN NEEDS A PROGRAM TO BRING THE ECONOMY INTO
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BALANCE AT A PACE WHICH WOULD NOT STRAIN THE NATIONAL

CONSENSUS "ON WHICH ALL HOPE OF INDUSTRIAL PROGRESS MUST DEPEND". THE IMF IS NOT SEEKING TO IMPOSE A MASSIVE DOSE OF DEFLATION. REFERRING TO THE SOCIAL CONTRACT AND INDUSTRIAL STRATEGY, HE SAID "ON THE CONTRARY, WE HAVE BEEN ASSURED THAT BASIC THRUST OF OUR POLICY IS RIGHT". THE IMF DOES NOT BELIEVE THAT FINANCIAL BALANCE IS POSSIBLE OVERNIGHT. "THEY RECOGNIZE WE NEED A 2 OR 3 YEAR STABILIZATION PROGRAM." THE UK ALONE MUST DECIDE "THE SIZE, NATURE AND FINANCING OF THE ADJUSTMENTS REQUIRED TO BRING OUR ECONOMY INTO BALANCE. WHEN WE HAVE TAKEN THIS DECISION, THE IMF WILL HAVE TO DECIDE WHETHER WE HAVE DECIDED WISELY." A STEADY AND CONTINUING REDUCTION IN PSBR IS NECESSARY; OTHERWISE, BORROWING COULD ONLY BE FINANCED AT HIGH INTEREST RATES THAT WOULD DAMAGE INDUSTRIAL POLICY. HOWEVER, PSBR REDUCTION SHOULD NOT BE ACHIEVED BY AN INCREASED INDIRECT TAXATION WHICH IS ALREADY DANGEROUSLY HIGH.

MR. HEALEY'S SPEECH ALSO INCLUDED SOME STRONG HINTS REGARDING THE TREASURY'S ECONOMIC FORECASTS. HE SAID THAT UNLESS WORLD TRADE IMPROVES, OUTPUT GROWTH MIGHT BE ONLY HALF AS HIGH IN 1977 HAD BEEN EXPECTED IN JULY. (IN JULY/AUGUST THE CHANCELLOR WAS FORECASTING 4-1/2 PERCENT GROWTH.) HE ALSO EXPECTS A CURRENT ACCOUNT SURPLUS WILL NOT BE ACHIEVED UNTIL 1978; THIS CONTRASTS WITH THE NIESR PREDICTION OF A LARGISH SURPLUS IN 1977.

2. THE PRIME MINISTER SAID ON BBC TELEVISION TUESDAY EVENING THAT THE IMF DOES NOT WANT TO IMPOSE ON BRITAIN A MASSIVE DOSE OF DEFLATION AND THAT THE FUND IS NOT SEEKING CHANGES IN THE THRUST OF THE GOVERNMENT'S POLICY.

3. IN FINANCIAL TIMES, JEREK MARTIN AND DAVID BELL REPORT FROM WASHINGTON IN AN ARTICLE ENTITLED "SOFTER LINE ON UK BALANCES" THAT THE U.S. SEEMS PREPARED TO TALK ABOUT THE FUTURE OF THE STERLING BALANCES PROVIDED BRITAIN AGREES TO IMF CONDITIONS IN RETURN FOR THE LOAN NOW BEING NEGOTIATED. SOFTENING OF THE AMERICAN POSITION FOLLOWS WEEKEND TALKS IN LONDON BETWEEN SECRETARY

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SIMON AND CHANCELLOR HEALEY. THE IMF NEGOTIATING TEAM HAS PROPOSED A PSBR REQUIREMENT OF 8 BILLION POUNDS FOR FY 77-78. IT ALSO SEEMS POSSIBLE THE U.S. MAY NOW BE WILLING TO CONSIDER TAKING PART IN THE INTERNATIONAL LOAN OR STANDBY FACILITY FOR BRITAIN THAT MIGHT FOLLOW SOON AFTER THE IMF AGREEMENT. PRECISE FORM OF THIS LOAN -- AND WHETHER OR NOT IT MIGHT BE AN EXTENSION OF THE \$5.3 BILLION STANDBY FACILITY -- IS NOT YET CLEAR. ANY

IMMEDIATE TALKS WITH THE U.S. WILL BE EXPLORATORY. U.S. INTENDS TO MAKE NO BINDING COMMITMENTS. IT REMAINS TO BE SEEN WHAT THE INCOMING CARTER ADMINISTRATION WILL DO.

4. DAVID BASNETT, GENERAL SECRETARY OF THE GENERAL AND MUNICIPAL WORKERS UNION, AND A LEADING MEMBER OF THE TUC ECONOMIC COMMITTEE, HAS TOLD US THAT HE AND OTHER TOP TUC LEADERS WILL BE MEETING THE PRIME MINISTER THIS EVENING (DECEMBER 1). ALTHOUGH THE PURPOSE OF THE MEETING IS OSTENSIBLY TO DISCUSS THE GOVERNMENT'S FAILURE TO IMPLEMENT SAFETY LEGISLATION, BASNETT ACKNOWLEDGED THAT THE ECONOMIC SITUATION WOULD UNDOUBTEDLY BE AN IMPORTANT TOPIC. HE SAID THAT WHILE TUC LEADERS NOW BELIEVE THAT "DRACONIAN" AUSTERITY MEASURES ARE NOT AS LIKELY AS THEY WERE A SHORT TIME AGO, THE TUC WILL REITERATE THE POSITION WHICH THEY HAVE CONSISTENTLY MADE CLEAR TO CHANCELLOR OF THE EXCHEQUER DENIS HEALEY, I.E., THAT SEVERE DEFLATIONARY ACTION WOULD BE COUNTER-PRODUCTIVE. IF THE GOVERNMENT WERE TO IMPOSE SUCH MEASURES, THE TUC WOULD STILL ABIDE BY THE CURRENT WAGE RESTRAINT POLICY BUT A THIRD ROUND OF WAGE RESTRAINT WOULD BE IN JEOPARDY. THE TUC WILL ALSO TRY TO WARN CALLAGHAN THAT THE GOVERNMENT "SHOULD NOT TAKE THE TUC FOR GRANTED - TO WATCH IT".

5. FOREIGN EXCHANGE AND FINANCIAL MARKETS. TUESDAY MORNING'S CALM WAS REPORTEDLY MILDLY DISTURBED BY A RUMOUR THAT GERMAN CHANCELLOR HELMUT SCHMIDT WOULD BACK THE U.K. WITH LOAN FACILITIES EVEN IF THE IMF DECLINED TO GRANT THE APPLIED FOR \$3.9 BILLION CREDIT. STERLING ROSE marginally ON THIS STORY, CLOSING AT \$1.6525, UP 0.4 CENTS ON THE DAY. THE TRADE-WEIGHTED DEPRECIATION NARROWED 0.3 PERCENTAGE POINTS TO 45.3. GILTS REACTED

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ADVERSELY, FEARING THAT SUCH A GUARANTEE WOULD WEAKEN THE GOVERNMENT'S DETERMINATION TO UNDERTAKE HARD BUT NEEDED MEASURES, AND PRICES FELL 1/4 POINTS ACROSS ALL MATURITIES. EQUITIES BEHAVED SIMILARLY AS THE FINANCIAL TIMES INDEX OF ORDINARY INDUSTRIALS FELL FROM 302.4 AT MONDAY'S CLOSE TO 297.6 AT TUESDAY'S. TRADING WAS THIN IN ALL MARKETS.

ON WEDNESDAY THE POUND OPENED JUST BELOW \$1.66 AND ROSE BY MID-MORNING TO \$1.6635.

6. SENATOR JAVITS, IN A WEDNESDAY MORNING PRESS CONFERENCE, STRESSED THAT WHILE THE \$3.9 BILLION IMF LOAN CAN BE MADE WITHOUT CONGRESSIONAL ACTION, ANYTHING BEYOND THAT WOULD REQUIRE CONGRESSIONAL ACTION. SEPTTEL

FOLLOWS. ARMSTRONG UNQTE ROBINSON

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